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THE MAGAZINE FOR GROWING COMPANIES

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(See page 54)

SEPT. 1985
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## THE TAKE AT THE TOP

# SALARIES, BONUSES, EQUITY, PERKS

## How Companies are Rewarding Top Executives

## The 100-Year-Old Start-Up: Reinventing the Family Business

## Assessing the Reagan Tax Plan

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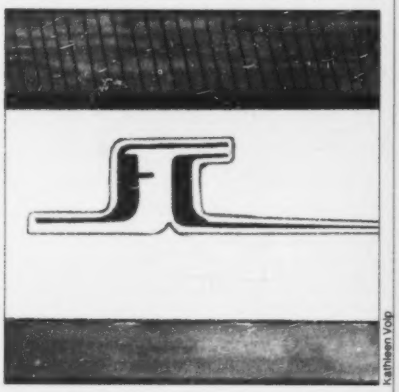

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96 **Paper planes**
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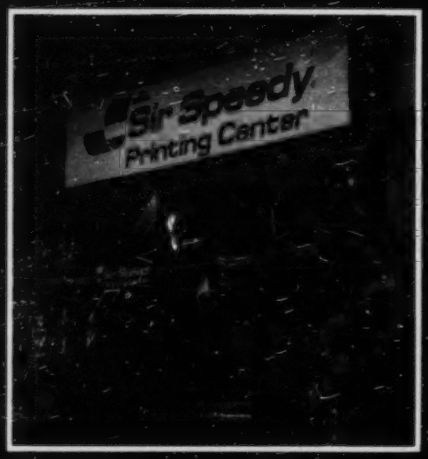


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ture to help them make better plastic molds. The Chinese wanted him to export the lower-grade molds that they were already producing. "It has to be a two-way deal," says Rosenholm, who turned it down. "You also have to buy something from them."

*—Joe Rosenbloom III*

**Times Change: In Pittsburgh,** the spiritual center of the Rust Belt, high-technology workers now outnumber steelworkers. While the steel business continued to disintegrate, the number of high-tech jobs grew last year at a rate of 29%, to at least 44,000. If this trend continues, local business leaders expect 1,000 high-tech companies in the area by 1990, compared with about 400 today.

**NEW MARKETS**

## Suppliers Weaned from Declining Industries

SMALL SUPPLIERS TO DECLINing industries have had a brutal time in the 1980s. But beyond the fields littered with casualties are some companies that used the difficult period to rethink their strategy, eventually adapting their strengths to new growth markets.

Independence Foundry and Manufacturing Co., of Independence, Mo., weaned itself from troubled customers in the auto, steel, and agricultural-tool businesses. For decades, the company was a supplier of cast-iron parts. "We felt like slaves to the bigger industries," says Independence president John Mitchell. "We have had half a dozen customers that just sort of ran our lives. We decided we'd had enough of that."

Mitchell focused on the consumer market instead. After scouting retail stores, he decided to use the mill's strengths—its casting and porcelain-coating capabilities—to make gourmet cooking pots. Now Independence markets them through L. L. Bean and Brookstone catalogs, and profit margins have quintupled, reaching 15% to 20% of sales. "We had always wanted to be more market-oriented," says Mitchell. "The cookware business has forced us to be."

HANK YOUNG/BLACK STAR

*President John Mitchell has repositioned Independence Foundry into the retail cookware business.*

Another company, Hall Industries Inc., of Pittsburgh, has undergone a similar reorientation. Since 1966, Hall has derived more than 50% of its revenues by making ladles, furnace parts, and other steel-mill equipment for such giants as United States Steel Corp. and Jones & Laughlin Steel Corp. When the industry collapsed in the early 1980s, Hall laid off half of its 120 employees.

Yet Hall has doubled its prerecession sales to almost $5 million. Seventy percent comes from new business that leverages the company's old production strengths with an emphasis on engineering. Hall now does $2 million of work in transportation, including development of the carriage for Pittsburgh's light rail system. "Because we're small and flexible, we found that our manufacturing could help our engineering, and our engineering could help sell our manufacturing," says Jonathan Hall, the company's vice-president. *—Greg Critser*

**SCORECARD**

## No Free Lunch

Business meal expenses are under scrutiny again. The Reagan Administration's tax package would permit companies to deduct all of their meal expenses up to $25 per person per meal. Above that limit, only half the expenses would be deductible.

The plan could mean trouble for your company, depending on where and when you dine. A recent survey by Laventhol & Horwath, the national accounting firm, found that meal costs exceed $75 a day, including tax and tip, only in New York City. But dinner runs more than $25 in 52 cities—and these figures don't include any of the wine and liquor that often accompany business meals. With drinks, an executive could easily run up a $40 lunch bill in many locations. Costs vary widely. In New York City, a dinner of shrimp cocktail, prime rib, salad, vegetables, ice cream, and coffee costs an average of $47.79; you can eat the same meal in Melbourne, Fla., for only $17.03.

L&H found that the average cost of travel, including meals, lodging, and rental car, was $137.66 a day. Some cities were surprisingly inexpensive in one category but scored high overall. Boston and Philadelphia, while not in the top 10 for meal costs, ranked second and fifth overall because of expensive hotel rooms and rental cars. Once again, Melbourne had the lowest overall costs—$96.51 a day, just a bit more than the cost of three meals in the Big Apple. Here are the 10 cities with the highest meal costs. *—V.I.*

| Rank | City | Breakfast | Lunch | Dinner | Total |
|---|---|---|---|---|---|
| 1. | New York City | $4.72 | $25.26 | $47.79 | $87.77 |
| 2. | Washington, D.C. | 10.85 | 18.68 | 35.24 | 64.77 |
| 3. | Dallas | 11.90 | 19.68 | 32.24 | 63.82 |
| 4. | San Francisco | 12.33 | 19.06 | 31.90 | 63.29 |
| 5. | Santa Barbara, Calif. | 10.67 | 16.12 | 32.39 | 59.18 |
| 6. | Seattle | 10.01 | 16.22 | 31.37 | 57.60 |
| 7. | Houston | 10.61 | 15.75 | 31.17 | 57.53 |
| 8. | New Orleans | 9.45 | 16.80 | 30.75 | 57.00 |
| 9. | Chicago | 9.40 | 14.74 | 32.28 | 56.42 |
| 10. | Los Angeles | 9.82 | 16.75 | 29.15 | 55.72 |

# THE TAKE AT THE TOP

Gain-sharing, revenue-sharing, equity participation, and more bonus systems than you can shake a stick at— when it comes to rewarding key employees, the days of the old-fashioned merit raise are numbered. BY TIM SMART

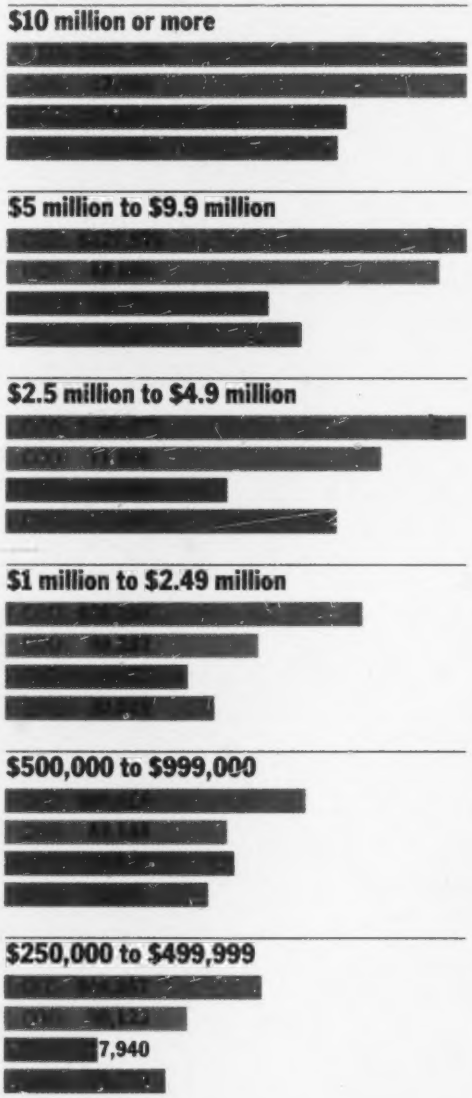
On a table in the corner of Ken Swanson's neatly appointed Silicon Valley office sits a box with a $10,000 Rolex watch inside. It is a none-too-subtle reminder of the stakes that Swanson encourages his young managers to play for. Swanson's seven project managers know that if any of them brings $500,000 in gross profits to Swanson's $20-million construction company, he will wind up with a watch just like the one on the table.

The Rolex might seem a bit superfluous at a company where young managers in their mid-twenties can earn upward of $100,000 a year, but it is an example of the enticements that owners of fast-growing companies dangle in front of key employees. The incentives may differ from company to company—a one-week, all-expense paid Caribbean cruise, a late-model BMW, a $100 bill, even a six-pack of beer—but the purpose is the same. When a company wants to spark sales, push profits to new highs, or reduce ever-escalating expenses, there is no surer way to get an employee's attention than to reward his performance with pay.

Unlike the world of big business, where regimented compensation schemes designed by well-paid consultants are the norm, the policies and practices followed by the 516 companies that answered INC.'s Executive Compensation Survey are as varied as they are original. At John Stack's $25-million Springfield Remanufacturing Center Corp., in Springfield, Mo., the keystone of the plan is an 82-page financial statement that is distributed monthly to the company's 200-plus employees. Each employee, from chief executive officer to broom pusher, has performance standards and incentive bonuses; with the monthly statement, each worker can measure how big his or her bonus will be. In Green Bay, Wis., Ryan Transfer Corp. president Bill Ryan follows a much simpler system: Every driver with more than a year's seniority at his

## How your pay stacks up— by revenues

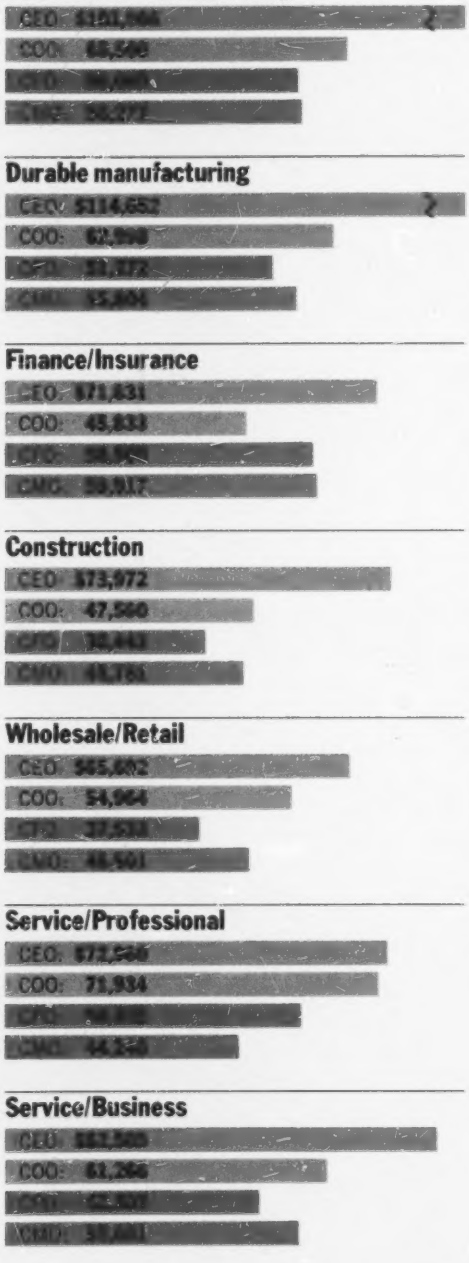
The most important factor affecting the average compensation for top executives is the size of the company. Figures represent total compensation—base salary and bonus.




CHARTS AND TABLES BY BERGMAN HAKE DESIGN

## How your pay stacks up—by industry

Manufacturing, both durable and nondurable, continues to offer the highest pay for top executives, while service companies trail behind.




trucking company gets paid a percentage of the weekly revenues.

Implicit in both of these approaches is an attempt to tailor compensation plans to fit the specific needs of each company. As the owners and managers of small to medium-size private companies will attest, there are no set formulas, no panaceas, no clear paths to follow when it comes to setting pay strategies for the employees who make their companies tick. "Like everybody, I'm constantly searching for the magical formula to keep them motivated," says Robert Clark, the owner of Fort Collins, Colo.-based Concept Systems Inc., a 15-employee producer of educational materials for scuba-diving schools.

Many small companies find it especially hard to decide which employees should be singled out for special "executive" treatment, if only because the efforts of one group of workers are often hard to separate from those of another. In response, more and more are linking executive compensation to overall employee compensation and, in some cases, opting for a single compensation system rather than the traditional multitiered approach.

This is one trend suggested by the survey responses, and there are others. They include: tying incentives to specific performance goals, spreading ownership among more employees, and deemphasizing the role of fixed salaries in the overall pay package. It is, of course, difficult to discern how strong or potentially long-lasting any of these trends might be, but they do indicate some of the ways that small companies are thinking about executive compensation.

Trends aside, there are many similarities between the results of last year's and this year's executive compensation surveys, which were both carried out with the assistance of Peat, Marwick, Mitchell & Co., the accounting and management consulting firm. The respondents are overwhelmingly founders, owners, or operators of private companies that have average annual sales of about $4.5 million. The companies are new to the battlefield of American business—two thirds did not exist 15 years ago. They average 49 employees and span the business spectrum from management consulting to steelmaking.

Total compensation for chief executive officers averages $82,494, up 19% from last year's $71,797. By comparison, the chief operating officer averages $61,044, the chief financial officer $48,426, and the chief marketing officer $52,124. The average CEO tends to be bullish on prospects for his business. Ninety percent of the companies expect to see their sales increase next year, with a little over a third anticipating revenue increases of more than 20%.

An overwhelming majority of the respondents, 86%, report a lack of any long-term incentive plans for their top people. Perhaps that is because many are young companies, where management is consumed with making ends meet rather than worrying about the distant future. Incentive stock options,

### Survey profiles: The Chief Executive Officer

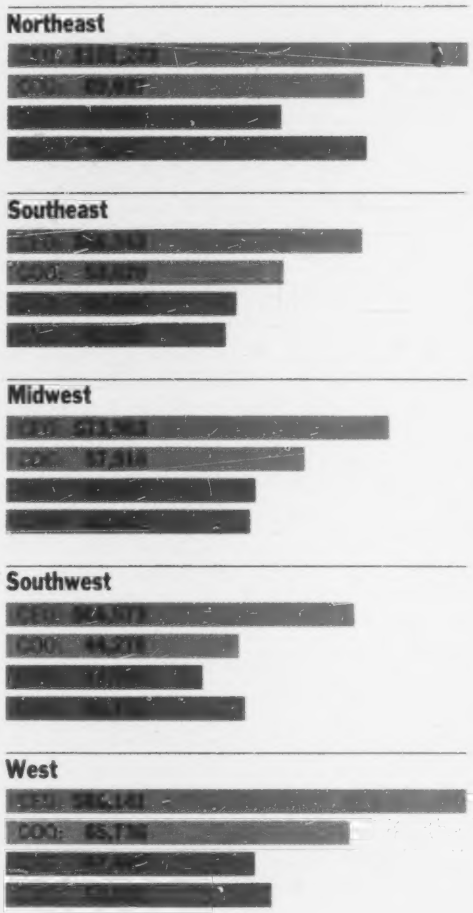
| | |
|---|---|
| Total compensation | $82,495 |
| Base salary | $62,080 |
| Percent receiving bonus | 59% |
| Bonus as a percentage of base salary | 45% |
| Percentage change in total compensation | +19% |
| Age | 45 |
| Years in position | 9 |
| Years with company | 11 |
| Founder | 71% |
| Board member | 80% |
| Stockholder | 92% |
| Average equity position | 67% |

### The Company

| | |
|---|---|
| Net revenues | $4,481,526 |
| Net pre tax income | $288,190 |
| Payroll | $1,000,465 |
| Payroll as a percentage of revenues | 22.3% |
| Employees | 49 |
| Projected revenue increase for next fiscal year | 15% |
| Age of company | 9 years |
| Percentage private | 95% |

## How your pay stacks up—by region

Executives on the coasts make out noticeably better than their counterparts in the rest of the country, with the Northeast the best-paying region.




popular among the nation's biggest industrial companies, are in place at only 6.5% of the respondents to the INC. survey, reflecting the traditional reluctance of owners of closely held companies to dilute their own holdings.

This doesn't mean, however, that companies have neglected forms of compensation other than straight salaries. Thirty-seven percent of the companies have taken steps to improve compensation other than salary during the past year, many adding such benefits as supplemental life and medical insurance or such perquisites as company cars and country-club dues and expenses. Often, these moves are in response to an outside threat—a competitor's attempt to hire away a key manager, for example. In general, the companies have the same mix of benefits found at larger, more established enterprises. A great majority offer medical and life insurance, and more than a third have profit sharing. The company car is still the executive perk of choice, with supplemental life insurance a close second.

As for their general thoughts about compensation, more than half of the respondents, 52%, say that establishing pay levels is their primary concern. Last year, the chief worry was controlling the spiraling rise in benefit costs. Peter T. Chingos, who heads Peat Marwick's executive compensation and personnel consulting unit, suggests that this change reflects economic trends more than anything else. Inflation has cooled, relieving some of the pressure of the increasing cost of employee benefits. A stronger economy has also led some companies to worry about whether their pay scales are sufficient to retain valued employees.

That concern has also fueled the trend toward performance-based compensation systems. "I think that there's a movement much more toward the tying of the reward systems of the individuals to the results of the company," says Bill Ryan, owner of the trucking company. "I also perceive that there's a movement on the part of a lot of employees, a desire to participate, almost a demand to participate, in the results. I think that those two concepts are somewhat linked, that if we do good and I contribute to that, then I want to participate in that in relationship to my contribution."

There is another reason that more companies are turning to performance-oriented compensation plans: They work. Peat Marwick's Chingos says his firm took a slice of the data from this year's survey and found that of the 100 fastest-growing companies (during the past five years), 28 had short-term performance plans in place. None of the slowest-growing 100 companies had short-term performance plans.

At Ken Swanson's construction company, for example, managers set gross profit goals for the year. If those are met, Swanson then deducts twice the managers' annual salaries and awards a bonus equal to 10% of the remainder. For a good manager earning $50,000 a year with a profit goal of $400,000, this bonus would amount to $30,000.

Some owners see in all this a human need that goes beyond the desire to earn more money. "People want to belong," says Bill Ryan. "They're either going to belong to unions, or they're going to belong to churches, they're going to belong to something. . . . It's basic human weakness that goes through their fiber. You give them something to belong to and it goes a long way."

Getting employees to feel part of the team involves more than just talk, though. It may involve a major change in the compensation plan in one case, a minor tinkering in another. Take Jess Brand, president of $5-million Brands Inc., a Columbus, Ind., lumberyard, who changed his annual bonus to a semiannual one. Why? "To keep it on people's minds," he says. Now, he thinks it may be necessary to move away from a discretionary bonus system based on a person's job tasks to one tied to the achievement of specific company goals.

Or consider Lucille Flint, president of Derma Science Laboratories Inc., a Rockwall, Tex., cosmetics manufacturer. Rather than part with equity in the business she and her husband own, Flint set up separate sales organizations, and the management of those entities can then earn and purchase equity in those companies. "We have found that's the best way to reward them, and I don't see why a lot of the bigger companies can't do that instead," she says.

Likewise, Keith Blakely, president of Advanced Refractory Technologies Inc., in Buffalo, has had to confront the equity question. His company's investors include local businesspeople, New York ven-

### Changes in compensation policy

| | Added | Cut |
|---|---|---|
| Short-term incentive plan | 37% | 1% |
| Long-term incentive plan | 31 | 0 |
| Health/retirement benefits | 36 | 8 |
| Perquisites | 17 | 2 |
| Special recognition/ awards | 19 | 0 |
| Performance appraisal system | 24 | 0 |

ture capitalists, and large industrial companies that want a window on promising new materials technology. Blakely knew that they did not want to see their holdings diluted further. But when he had to lure a key employee away from a bigger company, one able to pay a higher salary and offer more perks, equity became a deciding factor.

Considered almost a birthright by employees in high-tech Silicon Valley or Massachusetts Route 128 companies, getting a piece of the company is becoming increasingly common in all industries. At K. O. Swanson & Co., project managers are offered a chance to buy 5% stakes in some of the buildings the company erects and manages. If the employees don't have the cash to do so, the company will lend them the money at favorable interest rates. "If we're lucky, a $5,000 investment will be worth $20,000," says Swanson, noting that his people can buy into a building at wholesale prices and sell out at retail.

In addition, there is a trend to include more and more employees in equity plans. "In the small organizations, it's not uncommon to see every employee participating," says Jerrold Bratkovich, partner and general manager of the Los Angeles office of Hay Management Consultants.

But such tactics are not for every company. For some, just meeting the weekly payroll is a challenge. For owners of cash-poor and low-margin businesses, the words of Bill Ryan may ring true: "There is a rule of survival for small business. There are things that you want to have and things you can afford. You had better go with what you can afford."

*Reporting assistance for this article was provided by Patricia Amend.*

## THE FACTS BEHIND THE FIGURES

This report is based in part on an executive compensation survey conducted by INC. and Peat, Marwick, Mitchell & Co., the accounting and management consulting firm. A four-page questionnaire was mailed to a random sample of 22,500 INC. subscribers in February and the 516 responses were tabulated and cross-referenced by Peat Marwick.

The respondents represent small companies—95% of them privately held—in 48 states and the District of Columbia, with 21% headquartered in the Northeast, 15% in the Southeast, 34% in the Midwest, 9% in the Southwest, and the remainder in the West.

By industry category, the responses were 27% business services, 20% professional services, 22% wholesaling/retailing, 13% durable manufacturing, 7% nondurable manufacturing, 7% construction, and 4% finance/insurance.

INC. senior editor Mark K. Metzger coordinated the project. Peat Marwick's participation was provided through its Human Resources Consulting Group, with analysis by PM/Pay, the firm's compensation survey unit. Technical support was supplied by Peter T. Chingos, national practice director of Peat Marwick's Executive Compensation and Personnel Practices.

Complete results of the survey are available in a 25-page report published by INC. and Peat Marwick. The confidentiality of all responses is protected. To obtain a copy of the report, send a written request and a check for $55 to INC. Executive Compensation Study, Attn: John Titus, 38 Commercial Wharf, Boston, MA 02110, or call (800) 372-0018. In Massachusetts, call (617) 227-4700.

## Anaheim Custom Extruders: Playing the Game

Like any good game, the compensation scheme at Anaheim Custom Extruders Inc. is both simple and complex. William A. Czapar, founder and chief executive officer of the $2.5-million plastic-tubing manufacturer, has strung together a passel of incentives, each kicking in as a specific sales, profit, or productivity target is met. The idea behind it all is straightforward: The employees win when the company wins.

"Spend a buck to make two" is how Czapar likes to characterize it. Earlier this year, for example, Czapar took his top two managers out to dinner at a private club. He made sure their wives came along. Then Czapar made them all a promise: If the company's sales increased 30%, to $3.25 million, all of them could expect a one-week, all-expense-paid Caribbean cruise as a reward.

"My goal was to get the wives involved," says Czapar. "Then there's a little push from behind." The cruises will cost no more than $15,000, Czapar estimates, but the 30% increase in sales would yield an extra $50,000 in pretax, prebonus profits to the company.

The Anaheim compensation plan begins with sales estimates. Czapar has three categories: optimistic, pessimistic, and target. This year, the numbers are $3.25 million, $2.75 million, and $3 million. From those points, Czapar can determine his net pretax, prebonus profits, then set aside 28% as a bonus pool. All employees will be paid a bonus in direct proportion to their base salary.

To the annual bonus, which is paid according to whichever sales goal is achieved, and the cruise, which will be given only if the optimistic sales estimate is right, Czapar has added another twist. If the company hits its target sales forecast, $3 million this year, then key employees will receive a gift of stock in the private company equal to 10% of their base salary. If Anaheim reaches $3.25 million, then the stock grant will be equal to 20% of those salaries.

One theme that runs rampant throughout Czapar's approach to compensation is that all the employees in the company must have incentives. That is not to say all get the same, though. Workers on the shop floor get $15 or $25 bonuses and a six-pack of beer (soda for teetotalers) for achieving plant-wide productivity goals.

"At the end of the shift, guys are standing around the foreman to see how they've done," Czapar says. "It's more than a lousy $4 for the beer. It's recognition that they have done a good job. What I have created is a series of games within a game. It's a fun game," he adds, "and by God, work ought to be fun."—*Tim Smart*

*TAKE AT THE TOP (cont.)*

**"It's more than a lousy $4 for the beer," says William A. Czapar, CEO of Anaheim Custom Extruders. "What I have created is a series of games within a game."**

BRIAN SMITH/BLACK STAR

BUCK MILLER/BLACK STAR

**Bill Ryan puts the revenue each driver generates on his weekly paycheck. "If the company has a good week, Kaboom! . . . he knows it. That's good for him because it's good for the company."**

## Ryan Transfer: Share and Share Alike

In April 1980, Bill Ryan felt he had nowhere to turn. Granted, his trucking company's revenues had doubled every year since he had founded it five years before. But now he was facing disaster with the recession creeping in on his customers, mostly paper mills and grocery distributors near his Green Bay, Wis., headquarters.

Cash had become a serious problem: Ryan could barely keep up with the payments on the equipment he had bought the previous year, when business was expanding. He was facing stiff maintenance expenses on his truck fleet, catching up after the long, harsh Wisconsin winter. And, as usual, sales were slow in the spring.

"I knew that something had to give," says Ryan. "If it didn't, I knew I'd have to lay off a lot of people—or lose the company."

Labor was Ryan Transfer's highest fixed cost and, in view of the situation, Ryan decided there was no way he could continue to pay a fixed wage. He initiated a sharing plan. The company's employees, managers and CEO included, would divvy up a flat 40% of gross sales, rather than receiving regular salaries or hourly wages.

"It was tough," says Ryan, his voice edged with concern. "We pretty much had our backs to the wall and everybody knew it. We didn't know if we'd survive another month or two. People were nervous, but they accepted it because they knew times were tough. If it hadn't been that way, the plan would have been very difficult to sell. At that time, the plan helped me avoid layoffs. Without it, I don't think I'd have the company."

Revenue sharing didn't just save the company. Ryan believes it actually helped the company grow from $1 million that year to $4.2 million in 1984.

"If an employee is on a fixed wage, he loses touch with reality," explains Ryan, a wiry 45-year-old. "He doesn't know if the company is going through good times or bad." To further get the message across, Ryan puts the revenue each driver generates on his weekly check stub. "If the company has a good week, Kaboom! . . . he knows it. In the long run, that's good for him because it's good for the company.

"The beauty of this fluctuating payroll is that we can go with the waves," Ryan says. "If we do a better job, and we can justify better rates, our people automatically get a pay raise. Whatever business we do, the people share in what we get. I can't guarantee a guy $13 an hour if a shipper will pay the equivalent of $8. I can't soak the shipper for that. What I can do is channel the business so our people can work for the shippers."

After their first year on the job, drivers are eligible to move from hourly wages to the revenue-sharing plan, which currently includes 20 drivers. Another 25 drivers—part-timers and those with less than a year's seniority—are paid by the hour. The 45 drivers are paid from the 40% slice of revenues, with revenue-sharing drivers dividing up the balance after the hourly wages are paid.

Drivers in the revenue group generally make more than the wage earners, although a revenue-sharing driver's effective rate can fluctuate from a low of about $8 an hour during a slow week to a high of about $11 during a very busy one.

When Ryan initiated the sharing plan, he, with an administrative assistant, was the management. Today, there are 10 people in management and administration, in a separate revenue-sharing group, dividing up 10% of revenues. Ryan pays himself 1% to 2% from that 10% pool, depending on company performance.

There is one exception to the revenue-sharing plan: long hauls, which are lower-margin deals. "Because fuel costs are so high on a long trip, I can't afford to pay the drivers the same percentage of the sale, so I pay them by the mile. They would make out a lot better if I paid them a percentage, so some of them don't understand that, but they've accepted it."

The sort of revenue-sharing plan that Ryan instituted has found support in an unexpected quarter: academia. Massachusetts Institute of Technology economist Martin L. Weitzman has recommended a type of sharing system at the company level as a cure for inflation and unemployment in the larger economy.

Whatever its global implications, the idea seems to be working for Ryan. "Now that we've been on this system, I don't think people would want to change back," he says. "When things are dry, they know some checks will be smaller. But when it rains, they do well."

The pay system, however, may now be undergoing its greatest test. Ryan has had to cut back from operating in six states to working within a 200-mile radius of Green Bay while he copes with insurance premiums that have jumped dramatically and sales that may drop as low as $2.5 million this year. "I'm convinced," he says, "that if we got tied down to a wage system, we'd probably go out of business, and what good would that do employees?"—*Patricia Amend*

*TAKE AT THE TOP (cont.)*

## Custom Components: Tailoring the Take

Compensation plans at smaller companies in many cases are rather haphazard affairs, a pastiche of a series of *ad hoc* decisions. Some companies, however, have created similarly varied pay plans, not through accident, but as a conscious attempt to mold the plan to address the people and challenges within the company.

That was the case at Custom Components Inc., a highly profitable made-to-order military solid-state components manufacturer in Lebanon, N.J. At Custom, president Charles Blaine had to make distinctions in his compensation plan to acknowledge the different responsibilities and professional backgrounds of his top two managers.

The chief issue for his production manager was motivation. In Custom's early days, the around $2-million company had enjoyed a heady financial performance that included gross profit margins upward of 70%. After a few years, though, Blaine noticed that the margins were slipping a percentage point here and there.

Blaine decided to change the way he paid the general manager, who is responsible for production and who also carries the title of vice-president. Up until that point, the employee had been taking home a fixed salary with no incentives. So Blaine added a monthly bonus plan, triggered once gross margins reach 55%. Above that point, the manager receives a share of the gross profits that climbs in eight steps from .75% to 2.5%. The maximum rate is reached when gross margins are at 72.5% or higher. In a good year, that could add up to $12,000 to $15,000.

"Let me tell you, that really works," says Blaine, flipping through sheets of paper to check gross profit margins for recent months. "Before we instituted that, our margins were around 60%. Last year, the company's gross was over 75%.

"It was to motivate him," Blaine says of his general manager. "You have to make [the incentive] key to whatever he controls."

The problem was quite different when Blaine set out two years ago to hire a top engineer to oversee development of a new product line. The engineer, recruited from an established company on Massachusetts Route 128, wanted an equity stake for making the move to the tiny New Jersey company, but Blaine didn't want to part with any of his holdings. Instead, he set up a second company to manufacture and market the new products and gave his new hire a piece of that company. The new vice-president also receives 10% of net profits once the net return passes 10% of sales.—*T.S.*

**Charles Blaine had to devise entirely different compensation plans for his two top managers, one based on short-term performance and one built around an equity offer.**

## Bahr Brothers Mfg.: Gains Burghers

Recently, an order for castings with an unusually quick deadline came into Bahr Brothers Manufacturing Inc., a foundry and machine shop in Marion, Ind. To do the job, employees had to work round-the-clock instead of the customary eight-hour shifts. But the order was completed and the customer was satisfied, all without a groan or a grimace from the workers. In fact, employees were glad to do the extra work in a short time because they knew their gain-sharing checks would be fatter at the end of the month.

Gain-sharing, a broad term for programs that give frequent bonuses when employees increase their output, is a concept that caught chief executive officer Bill Jackson's interest during his 20 years as a manager of several Midwestern foundries. At one Michigan company, he realized that the company made money when labor was 33% of gross sales or less, and lost money when labor costs ran higher. Gain-sharing seemed to be a way to keep labor costs under control. The idea was a little too radical for Jackson's employers, however, so in 1966, he bought Bahr Bros. with the aim of installing a gain-sharing plan for all employees, managers included.

JOHN STARKEY/BLACK STAR

**With a gain-sharing plan, Jeff (left) and Bill Jackson's foundry grew 15-fold during a turbulent period when many competitors disappeared.**

Under gain-sharing, sales at Bahr Bros. have grown from $110,000 in 1966 to $1.8 million in 1984—during a turbulent period when dozens of foundries have disappeared and the survivors have had to contend with the fiercest overseas competition they have ever known.

Gain-sharing, Jackson believes, has been an important factor in Bahr Bros.'s success. In fact, he is so enamored of the concept that he is turning control of the company over to his son, Jeff, in order to pursue a consulting business, advising other companies on how to set up gain-sharing plans.

There are many different formulas that can be used in gain-sharing. Jackson based Bahr Bros.'s plan on labor because it was the simplest and easiest for employees to understand. He also established separate plans for hourly and salaried workers, reflecting the different skills and responsibilities of each group. The hourly plan uses 27.3% of gross sales as a target labor cost, figuring in employee benefits and the cost of any returned product. When labor costs for a month run less than 27.3%, the difference in dollars is divided among all hourly employees.

To promote a team spirit, the salaried plan is tied to the hourly plan. An amount equal to 15% of the hourly plan is divided among the salesperson, the superintendent, and two administrative employees. Jeff Jackson, vice-president and general manager, now receives a salary and a percentage of sales.

In addition to motivating workers to hold costs down, the younger Jackson relies on gain-sharing as an indicator of company performance. "The plan is a management tool that allows us to predict the company's profitability for every four-week period," he says. "In 1982, it told us we needed to make some drastic changes immediately because the work wasn't profitable. If we hadn't had gain-sharing, we might have lost the company."—*P.A.*

*TAKE AT THE TOP (cont.)*

## Right Associates: 28 Entrepreneurs

Frank Louchheim had a pretty clear idea of the kind of company he wanted when he and three others set up Right Associates five years ago. He knew that most of the business for the fledgling outplacement firm would flow from *Fortune* 500 companies, and that, to serve their needs, he would quickly have to build a national network of offices. But he didn't want to go deeply into debt to do it and risk strangling the young company's cash flow with interest payments.

Louchheim's answer was to set up each office as a separate profit center, headed by a manager with the authority to run the business as he or she saw fit. Each office would be expected to break into the black in its first year and provide a constant stream of start-up cash for new offices thereafter. To make the system work, Louchheim knew that he would have to attract experienced, entrepreneurial managers who would thrive on independence. The lure would be a compensation system that treats each manager as an entrepreneur: The higher the office's profit, the higher the manager's pay.

This was familiar territory to Louchheim. Before starting Right, he and his three co-founders had been independent consultants, and had worked together doing outplacement counseling for other organizations. Each operated in a different city and received straight commissions. "When we started, we didn't have enough volume to pay a salary," says Louchheim. "So we lived or died by what we did in our own offices."

Working from his own experience, he developed the strategy that has allowed Right Associates to set up 28 offices throughout the United States, with no long-term debt. In the next five years, the company plans to add 15 to 25 more offices in this country and some overseas, all largely financed internally, although there may be a need for a private placement or a public offering.

The key to the Right system is the company's corps of office managers, paid under a compensation plan that was designed to attract and keep the best talent. To start, each manager receives an "extremely modest" base salary for managing the office. The manager gets another salary for time spent actually counseling clients, plus a commission on the office's sales. In addition, the manager has an operating profit target. If the target is hit, he or she gets 10%. For every point over, the manager receives an extra percentage point of bonus, with a maximum of 20%. If the target is missed, there is a half-point deduction, with a 5% floor. "An office manager," says chief financial officer Stan Tilton, "can earn from 50% to 100% or more over and above his or her salary in bonuses. We have one person at 600%."

In addition, after a year, every office manager who meets goals receives stock options "commensurate with the size of the office and its contribution to the size of the company," adds Tilton.

Office managers report to Louchheim or to the director of regional offices with "dotted line" responsibility to Tilton for administrative and financial duties. "We've attempted to create 28 entrepreneurs," says Tilton. "And that's a very difficult thing to do as we grow. We went from 13 offices to 28 in less than three years. We have some systems and procedures in place, but not enough to tie ropes around our managers' necks."

"No ropes" means that Right has only a skeleton corporate staff at headquarters, and their compensation is geared toward helping the offices reach their goals. The staff is headed by Louchheim, who receives a salary and graduated bonus based on predetermined, tiered sales goals. Another bonus is based on a goal of net income before taxes. Tilton receives a salary plus one bonus based on net operating profit goals, and another bonus based on a cost-reduction program.

SAL DIMARCO/BLACK STAR

**To make his network of autonomous Right Associates offices work, CEO Frank Louchheim had to set up a compensation system that would treat each office manager as an entrepreneur.**

Another officer, in charge of training, product development, and maintenance, receives a salary and two bonuses, one based on the number of weeks he reduces "landing time"—the time it takes a candidate to land a new job—and a second bonus that is a percentage of sales on new products he develops and brings to market.

A third officer, the director of regional offices, receives a salary and a percentage of a predetermined sales goal. If he exceeds that target, he receives a graduated percentage of the excess.

To reduce the temptation of corporate officers to put too much pressure on office managers, the system has some buffers. "I get an incentive based on the aggregate operating incomes of all of the offices," explains Tilton. "If 26 make it and 2 don't, for example, our compensation committee, which is made up of officers and members of our board, will look at the total effort rather than just the bottom line. I have a 'fail-safe bonus' which has a limit of 20% of my annual salary if I don't make my goals. Otherwise, the pressure would short-circuit the incentives."

Right's incentive program is also a useful performance indicator that sends up a red flag in the event of trouble. Says Tilton: "If two offices don't make the goal, then we know where to concentrate our efforts."

Whether Right Associates can remain decentralized and keep its entrepreneurial style as it continues to expand is a matter of some disagreement between Louchheim and Tilton. It reflects a healthy tug-of-war between CEO and CFO. "What'll probably happen is that another tier [of management] will come in, an eastern region and a western region," says Tilton. "I hope not," says Louchheim from across the conference table. "I think when people can't talk to you, you lose something. I don't care if people call me at six in the morning. I'd rather spend the time on the phone talking the problem through." —*P.A.*